Alberta Heritage Savings Trust Fund

BUSINESS PLAN 2006-09

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The Business Plan was reviewed and approved by Treasury Board on February 1, 2006, and by the Legislature's Standing Committee on the Alberta Heritage Savings Trust Fund on February 8, 2006.

Subsequent Events: After the Business Plan was reviewed by the Legislature's Standing Committee, the government decided to deposit $1 billion into the Heritage Fund in 2005-06 and a further $1 billion in 2006-07. In addition, a decision was made to make an early repayment of the Alberta Social Housing Corporation's debentures held by the Heritage Fund. The Heritage Fund Income Forecasts Table on page 370 and the Heritage Fund Expense Forecast Table on page 372 have been updated to reflect these decisions.

INTRODUCTION

This is the tenth business plan for the Alberta Heritage Savings Trust Fund (Heritage Fund), which amends the previous business plans and incorporates updated financial information and income forecasts. The plan sets out specific investment objectives, goals and strategies to achieve the Heritage Fund's objectives as expressed in the legislation.

MISSION

The mission of the Heritage Fund is to provide prudent stewardship of the savings from Alberta's non-renewable resources by providing the greatest financial returns on those savings for current and future generations of Albertans.[1]

BACKGROUND AND FISCAL CONTEXT

- The Heritage Fund was created in 1976 to save a portion of non-renewable resource revenue. The Heritage Fund grew from a portion of Alberta's oil and gas revenue being deposited into the Fund from inception until 1987. As well, prior to 1982, the Heritage Fund retained its income.

- On January 1, 1997, the Heritage Fund was restructured in response to a public review and, after a transition period, is now an endowment fund. The restructuring included a new governance structure as well as the establishment of new investment objectives and performance measures.

- Public consultation on the future mandate of the Heritage Fund was conducted in the form of a survey mailed to all Alberta households in 2002. The survey confirmed the importance of the Heritage Fund as an endowment, underscoring the need to preserve its real value over the long term.

- The *Alberta Heritage Savings Trust Fund Act* includes a provision to retain a portion of the Heritage Fund's income in the Fund to protect its real value. Regular inflation-proofing of the Heritage Fund commenced in 2005-06.

- Assets and income of the Heritage Fund are fully consolidated with the assets and revenue of the Province. All income earned during a fiscal year is transferred to the General Revenue Fund (GRF), except for amounts retained for inflation proofing.

- In accordance with the *Access to the Future Act*, additional assets will be allocated to the Access to the Future endowment within the Heritage Fund, up a maximum of $3 billion. An amount equal to 4½ percent of the endowment will be allocated annually to the Access to the Future Fund from the General Revenue Fund to enhance advanced education opportunities for Albertans. An initial allocation of $750 million has been made to the Heritage Fund for this purpose in 2005-06.

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[1] Preamble to the *Alberta Heritage Savings Trust Fund Act*.

HERITAGE FUND STRUCTURE AND INVESTMENT OBJECTIVE

The *Alberta Heritage Savings Trust Fund Act* created an endowment with the objective of maximizing long-term financial returns. The Act requires the Minister of Finance, when making investments, to adhere to investment and lending policies, standards and procedures that a reasonable and prudent person would apply in respect of a portfolio of investments to avoid undue risk of loss and obtain a reasonable return that will enable the endowment to meet its objectives.

GOALS, INVESTMENT STRATEGIES, OUTCOMES AND PERFORMANCE MEASURES

GOAL ONE 1 Preserve the real value of assets

What it means The *Alberta Heritage Savings Trust Fund Act* provides for the maintenance of the Fund's real value by requiring the Heritage Fund to be inflation-proofed. Investments must be made with the objective of maximizing long-term financial returns. Equities have typically provided investors with higher historical total returns (current income and capital appreciation) than fixed income investments, and therefore constitute a significant proportion of the portfolio.

Strategy

- In accordance with the *Alberta Heritage Savings Trust Fund Act*, retain a portion of Heritage Fund income equal to the value of the Fund at the end of the fiscal year multiplied by the percentage increase in the Canadian gross domestic product price index. This will ensure that the Heritage Fund grows with inflation over time.

GOAL TWO 2 Achieve budgeted cumulative income forecasts during a 5-year planning horizon

What it means Heritage Fund income is included in consolidated revenue of the province. Consequently, the level and variability of Heritage Fund income is important to the government's fiscal plan. However, the benefit of long-term capital appreciation is also desired.

The Heritage Fund is invested in a diversified portfolio that includes fixed income securities, Canadian equities, US equities, non-North American equities, private equity and income investments, absolute return strategies, timberland and real estate. The Fund is invested to generate long-term returns to assist in supporting the Province's income and spending needs. It is widely accepted that a prudent mix of interest-bearing securities, equities, real estate and alternative asset classes best achieves the objective of optimizing financial returns as it provides enhanced expected returns and diversifies risk. While income may fluctuate from year to year, over a five-year period it is reasonable to expect income forecasts to be met.

The following strategies, expected outcomes and performance measures pertain to both Goals 1 and 2.

Strategies

- Implement the policy asset mix as per the Heritage Fund's Investment Policy Statement. The asset mix was based on the conclusion of a 2003 asset mix study and a review of current market conditions and new investment products. See Table 1 for the current policy allocation of the Heritage Fund.

    - Increase investments in non-traditional asset classes.

      Increasing exposure to non-traditional asset classes (e.g. absolute return strategies and private investments) can create a portfolio with improved risk/return trade-offs even after the additional investment costs associated with these assets are taken into account.

    - Reduce Canadian fixed income and public equity investments.

      These investments will be gradually reduced to accommodate the increase in non-traditional asset classes.

    - Review, and if deemed appropriate, add new investment products to potentially enhance return and reduce the total risk of the portfolio.

- Vary the allocation of assets to enhance returns.

  Based on the outlook for financial markets, Alberta Investment Management may vary the allocation of liquid assets to enhance returns.

TABLE 1: Current Policy Allocation and Policy Benchmarks

Allocation	Policy Benchmark	Actual as of Dec. 31, 2005	2005-06	2006-07	2007-08	2008-09
Cash & Absolute Return Strategies						
Money Market	Scotia Capital 91-Day Treasury Bill	0.6%	2%	1%	1%	1%
Absolute Return Strategies	HFRX Global Investable Index - Hedged C$	4.3%	5%	5%	5%	5%
Fixed Income						
Public Fixed Income	Scotia Capital Universe Bond Index	30.4%	33.0%	29.0%	29.0%	29.0%
Inflation Sensitive						
Real Estate	Investment Property Databank Large Institutional Property Index	10.7%	10.0%	10.0%	10.0%	10.0%
Private Income	CPI + 6%	0.6%	0.0%[1]	4.0%	4.0%	4.0%
Timberland	CPI + 4%	0.4%	0.0%	2.0%	2.0%	2.0%
Equities						
Canadian	Standard & Poor's / TSX Composite Index	20.4%	15.0%	15.0%	15.0%	15.0%
US	Standard & Poor's 1500 Index	14.5%	15.0%	15.0%	15.0%	15.0%
Non-North American	Morgan Stanley Capital International Europe, Australasia, Far East	16.5%	15.0%	15.0%	15.0%	15.0%
Private Equity	CPI + 8%	1.6%	5.0%1	4.0%	4.0%	4.0%
Total		100%	100%	100%	100%	100%
Additional Notional Exposures						
Active Currency Overlay[2]		-	5%	5%	5%	5%
Absolute Return Strategies Overlay[3]		-	5%	5%	5%	5%

1 In the 2005-08 Business Plan Policy Portfolio, the 5% allocation to Private Equities included allocations to both Private Equities and Private Income. However, the breakdown between Private Equities and Private Income was not separately disclosed.

2 Allocations to active currency overlays are shown as targeted notional exposure. These strategies have notional exposure to various currencies, but generally have near zero net exposure.

3 Absolute return strategy overlays are investments in absolute return strategies that are used in conjunction with public equity indices to enhance portfolio returns.

- Continue to practice responsible investing by investing in companies that operate legally and in countries that maintain normal trade relations with Canada. Also, use proxy voting to advance good governance and management practices.

Expected Outcomes

- Income forecasts are achieved on a cumulative basis over five years.
- Real value of assets is preserved over a 20-year horizon.
- The Heritage Fund policy asset mix is expected to generate a real rate of return of 4.5% at an acceptable level of risk over a moving five-year period.
- Active management will add 50 basis points (0.50%) of value above the stated benchmark return, over a moving 5-year period.

Performance Measures

- The market value rate of return of the policy benchmark will be compared against the Consumer Price Index (CPI) plus 4.5% to determine whether the investment policy is achieving the returns expected based on long-term capital market assumptions.
- The actual market value rate of return will be compared against the policy benchmark return to determine the impact of fund management on performance using the appropriate policy benchmarks for each asset class. Alberta Investment Management will seek to add 50 bps (0.50%) of value per year (after fees are deducted) over a five-year investment horizon.
- See Table 1 for the corresponding benchmark for each asset class and Appendix A for a description of each benchmark.
- Achieve sustained, real market value of assets.
- Achieve income forecasts over a 5-year planning horizon.

RISKS TO GOALS, INVESTMENT STRATEGIES, OUTCOMES AND PERFORMANCE MEASURES

Investment returns and income will vary significantly from year to year for the following reasons:

- The well-established capital market principle that increased expected returns are accompanied by increased risk.
- An investment policy to maximize long-term returns implies a weighting towards investments in equities. Equities have historically provided investors with higher total returns (dividends and capital gains) than fixed income investments; however, dividend yields in general are lower than interest rates. An equity portfolio will provide lower current income while the magnitude and timing of realizing capital gains is uncertain.
- Given a well-implemented private equities program, private equities can provide investment returns above those of public equities. However, by their nature, private equity investments are highly illiquid and are associated with an investment horizon of five to ten years to realize investment gains. Some private equity investments are subject to potentially large or total investment losses.
- Absolute returns strategies have gained prominence in recent years with an expectation of stable returns. However, this market is very fragmented, with many different strategies and investment fees above those of traditional managers. In some cases, there have been large losses sustained in the industry by otherwise well informed and highly professional investors. Manager selection and oversight are therefore critical to successful implementation.
- To better manage risks, Alberta Investment Management is in the process of implementing a comprehensive risk management program based on value-at-risk.

ACCOUNTABILITY TO ALBERTANS

GOAL THREE 3 Ensure the transparency of the Heritage Fund's objectives and results for Albertans

What it means Results from the Looking Forward survey confirm Albertans want a strong, healthy Heritage Fund that is used primarily for savings. Ongoing communication through published reports and news releases will ensure Albertans remain aware of the performance of the Heritage Fund.

Strategies

- Release quarterly and annual reports on a timely basis in simple, understandable language.
- Release summary reports of the Heritage Fund's investment activities and results for Albertans on a timely basis.
- Publish the Heritage Fund Business Plan annually.
- The Legislature's Standing Committee will hold annual public accountability meetings around Alberta to report on the Heritage Fund's results and to answer questions on the Fund's performance.

Expected Outcome

- Improved understanding by Albertans of the management, operations, investment philosophy and performance of the Heritage Fund.

Performance Measures

- Timeliness of reports and public accountability meetings.
- Knowledge of Albertans regarding information provided about the Heritage Fund.
- Annual report will be released by June 30 of each year.
- Quarterly reports will be released within two months after the conclusion of the quarter.
- Albertans are satisfied with their knowledge of the Heritage Fund, with 50% able to estimate the Fund's value.

MANAGEMENT AND ACCOUNTABILITY

- The mission and investment objectives for the Heritage Fund have been established in legislation and are summarized above.

- A Standing Committee of the Legislature has been created by legislation and has the following responsibilities:

  - To review and approve annually the business plan for the Heritage Fund;
  - To receive and review quarterly reports on the operation and results of the Heritage Fund;
  - To approve the annual report of the Heritage Fund;
  - To review after each fiscal year end the performance of the Heritage Fund and report to the Legislature as to whether the mission of the Heritage Fund is being fulfilled; and
  - To hold public meetings with Albertans on the investment activities and results of the Heritage Fund.

- The Minister of Finance is responsible for the operation of the Fund.

- The Endowment Fund Policy Committee advises the Minister of Finance by reviewing and recommending for approval the business plan, quarterly and annual reports, and the investment policies for the Heritage Fund. The Committee includes a majority of private sector members with relevant financial and business expertise.

- The Policy and Strategic Planning Division of Alberta Finance is responsible for providing investment policy support for the Heritage Fund to the Minister of Finance and the Endowment Fund Policy Committee.

- Alberta Investment Management, the investment operations group of Alberta Finance, makes ongoing investment decisions. Alberta Investment Management uses external managers for certain investments that have the potential to generate high returns but require specialized resources.

- The Auditor General is the auditor of the Heritage Fund.

- When making investments, Alberta Investment Management, acting on behalf of the Minister of Finance, will adhere to investment and lending policies, standards and procedures that a reasonable and prudent person would apply in respect of a portfolio of investments to avoid undue risk or loss and obtain a reasonable return that will enable the Heritage Fund to meet its objectives. Therefore, the Fund is not to be used for economic development or social investment purposes.

INCOME AND EXPENSES

- Capital gains and losses on traditional investments are not recognized as income until the investment is sold or, given a significant loss, is written down. Therefore, gains and losses that are included in reported rates of return may not be immediately reflected in realized income. In contrast, income and expenses on equity index swaps are accrued as earned, resulting in gains and losses being realized as income as they occur.

The income forecasts include:

- Interest income;
- Dividend income;
- Capital gains or losses only when they are realized, such as when an investment is sold or written down; and
- Income and expense on index swaps and interest rate swaps accrued as earned.

- The income forecasts do not include unrealized capital gains. The Heritage Fund records investments at cost, which exclude unrealized gains and losses. The fair value of investments in provided for information purposes. CICA public sector standard setters are currently reviewing the issues surrounding the accounting and reporting of financial instruments at fair value for governments.

- Following are current forecasts of Heritage Fund income based on the assumptions noted. Actual results will vary from projected income depending on the extent to which actual interest rates and equity market returns vary from the assumptions used.

TABLE 2: Heritage Fund Income Forecasts

Forecast Annual Income ($ millions)	2005-06	2006-07	2007-08	2008-09
Unconsolidated Investment Income	1,212	917	833	847
Consolidated Investment Income	1,196	874	833	847
Amounts Retained for Inflation Proofing	(345)	(242)	(309)	(300)
Transfer to General Revenue Fund	867	675	525	546
Forecast Fair Value of the Fund ($billions)	14.3	15.5	15.8	16.3

The Heritage Fund income forecasts are supported by the assumptions made in the following tables.

TABLE 3: Asset Mix Assumptions

	2005-06[1]	2006-07	2007-08	2008-09
Money Market	0.8	1.0	1.0	1.0
Absolute Return Strategies	4.7	5.0	5.0	5.0
Fixed Income	31.7	29.0	29.0	29.0
Real Estate	9.8	10.0	10.0	10.0
Public Equities	50.2	45.0	45.0	45.0
Private Investments	2.4	8.0	8.0	8.0
Timberland	0.4	2.0	2.0	2.0

1 The assumptions for 2005-06 reflect the average asset class weights assumed by the forecast model, which take into account actual experience to Dec. 31, 2005 and the asset mix policy delineated in the 2005-08 Business Plan.

TABLE 4: Capital Market Rate of Return Expectations

	2005-06	2006-07	2007-08	2008-09
10-year Bond Rate	4.15	4.95	5.80	6.00
Canadian Public Equities	7.0	7.0	7.0	7.0
Foreign Public Equities	8.0	8.0	8.0	8.0
Private Investments, Timber, Absolute Return Strategies	8.5	8.5	8.5	8.5
C$/US$ Exchange Rate	0.84	0.86	0.85	0.85

Source for Return Expectations: Alberta Finance / Alberta Investment Management

RISKS TO THE INVESTMENT INCOME FORECAST

1. If equity returns are lower than assumed, accounting investment income will be lower depending on the extent of the decrease in equity returns and the amount and timing of turnover in the equity portion of the Heritage Fund.

2. If interest rates increase, the market price of bonds held by the Heritage Fund would typically decline. Accounting investment income will decrease depending on the extent of the interest rate increase and the amount and timing of turnover in the fixed income portion of the Heritage Fund.

EXPENSE FORECAST

The preceding forecasts of income for the Heritage Fund are gross of estimated direct investment expenses. Estimated investment expenses are as follows:

TABLE 5: Heritage Fund Expense Forecast[1]

	2006-07	2007-08	2008-09
		($ millions)	
Direct Management Costs	2.8	2.9	3.1
Externally Managed Investment Pools	31.5	33.7	36.1
Internally Managed Investment Pools	6.9	8.0	8.4
TOTAL	**41.2**	**44.6**	**47.6**
As a % of Fair Value	0.27%	0.28%	0.29%

1 Due to factors such as differences in assumed and actual experience in asset class allocations and growth in the size of the Heritage Fund, actual expenses may differ from forecasted expenses.

Administrative expenses include both direct and indirect administrative expenses, which include staff time, supplies and services, investment service costs and advisory services.

The forecast increase in costs is due to increased staff and systems costs, increased size of the fund, and increased allocation to non-traditional asset classes (absolute return strategies and private investments), which are more costly to manage.

APPENDIX A

Description of Benchmark Indices for the Heritage Fund

Scotia Capital 91-day T-Bills Index (SC T-Bills Index)
The T-Bill Index measures the performance of the Canadian money market. Comprised of 91-day Government of Canada treasury bills, which are rolled into new bills at each Government of Canada treasury bill auction. Maintained by Scotia Capital Management. The index provides a benchmark upon which the performance of the cash, short-term and money market investments of the Heritage Fund can be compared.

Scotia Capital Universe Bond Index
The Universe Bond Index provides a broad measure of the Canadian fixed income market. Consists of semi-annual pay fixed rate bonds issued domestically in Canada and denominated in Canadian dollars, with a remaining effective term to maturity of at least one year. It is an investment grade index, and thus only includes securities rated BBB and higher. Maintained by Scotia Capital Management. The index provides a benchmark upon which the performance of the longer-term fixed income investments of the Heritage Fund can be compared.

S&P/TSX Composite Index
With its broad economic sector coverage, the S&P/TSX Composite is the standard indicator of performance for Canadian equity markets. Comprised of over 70% of the market capitalization for Canadian-based, Toronto Stock Exchange listed issuers. Currently in the process of integrating income trusts into the Index with existing companies. Maintained by the S&P/TSX Index Committee, which comprises of 7 members representing both Standard & Poor's and the Toronto Stock Exchange. The index provides a benchmark upon which the performance of the Canadian equity investments of the Heritage Fund can be compared.

Standard & Poor's 500 Index
The S&P 500 is the standard gauge of the large capitalization, US equity market. Comprised of 500 leading companies in leading industries of the US economy, the S&P 500 has coverage of over 80% of the US equity market. Maintained by the S&P Index Committee, whose members include Standard and Poor's economists and index analysts. The index provides a benchmark upon which the large cap US equity investments of the Heritage Fund can be compared.

Standard & Poor's Composite 1500 Index
The S&P 1500 combines the S&P 500, S&P MidCap 400 and the S&P SmallCap 600 indices to provide a broad measure of the US equity market. Comprises approximately 90% of the market capitalization of investable US equities. Maintained by the S&P Index Committee. The index provides a benchmark upon which the performance of the US equity investments of the Heritage Fund can be compared.

Morgan Stanley Capital International Europe, Australasia, Far East Index (MSCI EAFE Index)
The MSCI EAFE is designed to measure international equity performance. Currently, the MSCI EAFE provides exposure to 21 different countries representing the developed markets outside of North America in Europe, Australasia and the Far East. Maintained by Morgan Stanley Capital International. The index provides a benchmark upon which the performance of the international equity investments of the Heritage Fund can be compared.

Consumer Price Index (CPI)
The Consumer Price Index (CPI) measures changes in consumer prices experienced by Canadians. The index includes about 600 commodities specified to represent the price movement in 169 basic commodity classes. The Index is maintained by Statistics Canada.

The CPI provides information on the relative performance of the Heritage Fund. The benchmark performance is CPI+4% for timberland investments, CPI+6% for private income investments, and CPI+8% for private equity investments.

IPD Large Institutional All Property Index
The IPD Large Institutional All Property Index measures the total return from the real estate portfolios of six large Canadian institutional investors, which have portfolios valued greater than $1.5 billion. Maintained by the Institute of Canadian Real Estate Investment Managers and International Property Databank. The index provides a benchmark upon which the real estate investments of the Heritage Fund can be compared.

HFRX Global Investable Index (Hedged C$)
This is a custom index with two components: a US dollar denominated index and a currency hedge. The index component is maintained by Hedge Fund Research, Inc. and utilizes an objective, rules-based methodology to diversify across hedge fund managers that have low correlations to traditional asset classes. The currency hedge component is maintained by AIM and reflects the return to be realized by passively hedging the underlying US dollar currency exposure. The custom index provides a benchmark upon which the absolute return strategies investments of the Heritage Fund can be compared.

APPENDIX B

Business Plan Performance Measures (as of December 31, 2005)

Business Plan Performance Measures
Time Weighted Rates of Return
(Percent %)

	Current Quarter	Nine Months	One Year	Five Years[1]
Overall Return[2]	3.2	10.3	12.6	5.7
ENDOWMENT PORTFOLIO				
Short term fixed income	0.7	2.0	2.7	3.1
SC 91 Day T-Bill	0.7	2.0	2.6	3.0
Long term fixed income	0.8	6.1	7.3	8.1
SC Universe Bond Index	0.7	5.3	6.5	7.4
Canadian equities	3.0	19.6	24.9	7.3
S&P/TSX Index	2.9	18.9	24.1	6.6
United States equities	2.3	3.1	1.7	(4.1)
S&P 1500 Index[3]	2.5	3.9	2.4	(4.2)
Non North American equities	4.9	12.3	13.2	0.4
MSCI EAFE Index	4.5	9.6	10.0	0.1
Real Estate	11.3	18.8	28.9	12.5
IPD Large All Property Index[4]	11.8	17.5	19.1	10.4
Absolute Return Strategies	0.4	2.5	4.6	n/a
HFRX Global Hedged Index[5]	1.2	6.3	8.0	n/a
Private equities	3.8	11.0	12.0	n/a
CPI + 8%	2.1	7.8	10.0	n/a
Private income	1.9	20.5	22.5	n/a
CPI + 6%	1.6	6.4	8.0	n/a
Timberland	(1.0)	n/a	n/a	n/a
CPI + 4%	1.1	n/a	n/a	n/a
Total Endowment Portfolio	3.2	10.3	12.6	4.9
Policy Benchmark	3.1	9.6	11.0	4.2

1 Returns for five years are annualized

2 The overall return includes the Endowment Portfolio and past returns of the Transition Portfolio which was wound up in the first half of 2002-03

3 Prior to April 1, 2004, the benchmark for US equities was the S&P 500 Index

4 The amounts reported for the IPD Large All Property Index are estimated and may vary significantly from the actual amounts when received. Prior to June 1, 2005, the benchmark for real estate was CPI plus 5%. Prior to April 1, 2002, the benchmark was the Russell Canadian Property Index

5 Prior to July 1, 2005, the benchmark return was CPI plus 6%

APPENDIX C

Glossary

Absolute Return Strategy
Absolute Return Strategies encompass a wide variety of investments with the objective of realizing positive returns regardless of the overall market direction. A common feature of many of these strategies is buying undervalued securities and selling short overvalued securities. Some of the major types of strategies include long/short equity, fixed income arbitrage, merger arbitrage, macroeconomic strategies, convertible arbitrage, distressed securities and short selling.

Active Management
Attempts to achieve portfolio returns greater than a specific index while controlling risk, either by forecasting broad market trends or by identifying particular mispriced sectors of a market or securities in a market.

Asset Allocation
The investment process by which the investment manager chooses or allocates funds among broad Asset Classes such as stocks and bonds.

Asset-Backed Securities
These are debt instruments collateralized by a pool of assets such as automobile loans or equipment leases.

Asset (or Investment) Class
Refers to a broad category of investments with similar characteristics (the typical asset classes are cash, stocks, bonds and real estate).

Benchmark Index
A Benchmark Index is a statistical yardstick tracking the ups and downs of a particular market by monitoring a representative group of securities over time. For example, the Scotia Capital Universe Bond Index is a benchmark index that is designed to reflect the changes in the Canadian bond market.

Bond
A bond is a financial instrument representing a debt where the issuer (corporation or government) promises to pay to the holder a specific rate of interest over the life of the bond. On the bond's maturity date, the principal is repaid in full to the holder.

Capital Gain (or Capital Loss)
The market value received on the sale of an asset, which is higher (lower) than its purchase price (also called cost or book value). If an asset is bought for $50 and sold for $75, the realized capital gain or profit is $25.

Diversification
Diversification is a process of allocation of investment assets within an Asset Class and among asset classes. Diversification is intended to reduce risk.

Dividends
Earnings distributed to shareholders of a company, proportionate to their ownership interest.

Duration (or Modified Duration)
Modified duration is a measure of price volatility and is the weighted average term to maturity of the security's cash flows (i.e., interest and principal), with weights proportional to the present value of the cash flows. Bonds with a longer duration are more price-sensitive to interest rate changes than bonds with short durations.

Equities
Equities are synonymously called stocks or shares and represent an ownership interest in a company (could be either a public or private firm). The shareholder normally has voting rights and may receive dividends based on their proportionate ownership.

Inflation
Increases in the general price level of goods and services. Inflation is one of the major risks to investors over the long-term as savings may actually buy less in the future.

Interest-Bearing Securities
An investment that is required to pay a fixed interest rate at periodic intervals such as bonds, mortgages and debentures.

Investment Grade
An investment grade bond is rated a minimum of BBB (or equivalent) by a rating agency, with AAA being the highest grade. Bonds rated below BBB are generally classified as being speculative grade and carry higher levels of credit risk than investment grade bonds (i.e., they have a higher probability of default on interest or principal payments).

Long-term
A long-term investment horizon in the context of the Heritage Fund means a period of time that would include two business cycles, which would generally mean about 10 years.

Market Value Rate of Return
An annual percentage, which measures the total proceeds, returned to the investor per dollar invested. Total proceeds for market value rates of return = "money in the bank" plus paper profits or losses (paper profits or losses are also called Unrealized Capital Gains or Losses). "Money in the bank" means cash interest and dividends and realized capital gains or losses from selling the investment.

Median Return
The median return of a group of investment managers reflects the return associated with the manager ranked at the 50th percentile (the 50th percentile is that point where half the managers had a higher return, and half the managers had a lower return).

Money Market Instruments
Debt instruments such as Treasury Bills or corporate paper with a maturity of less than one year.

Mortgage-Backed Securities (MBS)
An MBS is a debt instrument that has an ownership claim in a pool of mortgages or an obligation that is secured by such a pool.

Mortgage Investment
A mortgage investment is a debt instrument collateralized by real assets (e.g., a building) and requiring periodic payments consisting of interest and principal.

Nominal Rate of Return
A measure of the earnings performance of a fund measured in current dollars.

Passive Management
Buying or investing in a portfolio that represents a market index without attempting to search out mispriced sectors or securities.

Portfolio
A collection of investments owned by an investor.

Private Equity
An equity investment in a private (not publicly traded) company.

Private Income
A private investment that is structured to provide high current income. Examples of investment opportunities considered to be private income include infrastructure projects, bridge loans and corporate finance arrangements.

Real Rate of Return
The nominal rate of return minus the rate of inflation.

Realized/Unrealized
Terms generally used to describe Capital Gains or Losses. A gain or loss is generally realized when an asset is sold; prior to sale the gain or loss is unrealized and it is only a potential or "paper" gain or loss.

Timberland
Refers to investment in privately owned areas of woodland; that is, forested areas consisting of both hardwood and softwood species. When responsibly managed, timberland investments are a renewable and sustainable resource that responds to demand for lumber and paper products, and provides benefits such as diversification, an inflation hedge, and relatively high yield within the context of a portfolio.